

Auditor-General of South Africa

**Msunduzi Municipality and its
municipal entity**

Audit report 2017-18

Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and the council on Msunduzi Municipality

Report on the audit of the consolidated and separate financial statements

Adverse opinion

1. I have audited the consolidated and separate financial statements of the Msunduzi Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.
2. In my opinion, because of the significance of the matters described in the basis for adverse opinion section of this auditor's report, the consolidated and separate financial statements do not present fairly, in all material respects, the consolidated and separate financial position of the Msunduzi Municipality as at 30 June 2018, and its financial performance and its cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2017 (Act No. 3 of 2017) (Dora).

Basis for adverse opinion

Property, plant and equipment

3. The municipality did not appropriately account for property, plant and equipment in accordance with SA Standard of GRAP 17, *Property, plant and equipment*. Property, plant and equipment which the municipality did not own were incorrectly recognised and additions thereto were incorrectly recognised as operational expenditure. Capital assets under construction and additions included in note 14 to the consolidated and separate financial statements did not also agree to the reconciliation of property, plant and equipment included in the note. I was also unable to obtain sufficient appropriate audit evidence for additions and capital assets under construction capitalised to property, plant and equipment due to the municipality not effectively implementing and maintaining adequate asset management systems. I could not confirm the additions to property, plant and equipment by alternate means. Consequently, I was unable to determine whether any further adjustments to property, plant and equipment stated at R7,22 billion (2017: R7,08 billion) in note 14 to the consolidated and separate financial statements was necessary.

Consumer debtors

4. The municipality did not calculate impairments on consumer debtors in accordance with SA Standard of GRAP 104, *Financial instruments*. The estimated future cash flows were not present valued when determining the recoverable amounts for consumer debtors. Allowances for impairments included in note 4 to the consolidated and separate financial statements did not also agree the underlying supporting documentation and allowance for impairment reconciliations. In addition, I was unable to obtain sufficient appropriate audit evidence that

debtors from other service charges included as consumer debtors had been properly accounted for, as the municipality did not allocate these debtors to their respective categories of service charges. I was unable to confirm the consumer debtors by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to consumer debtors stated at R1,35 billion (2017: R1,01 billion) in note 4 to the consolidated and separate financial statements.

Revenue from exchange transactions – interest from consumer debtors and receivables

5. The municipality did not account for interest from consumer debtors and receivables in accordance with SA Standard of GRAP 9, *Revenue from exchange*. Interest was not charged on all overdue accounts and where interest was charged on consumer accounts it was incorrectly computed. I was unable to determine the full extent of the misstatement as it was impractical to do so. Consequently, interest from consumer debtors and receivables stated at R192,22 million included in note 30 to the consolidated and separate financial statements was misstated by an unknown amount.

Receivables from exchange transactions

6. During 2017, I was unable to obtain sufficient appropriate audit evidence and confirm by alternative means the Independent Development Trust receivable. Consequently, I was unable to determine whether any adjustment was necessary to receivables from exchange transactions stated at R81,97 million. My audit opinion on the consolidated and separate financial statements for the period ended 30 June 2017 was modified accordingly. My opinion on the current year consolidated and separate financial statements was also modified because of the possible effect of this matter on the comparability of the receivables from exchange transactions for the current period.

Payables from exchange transactions

7. I was unable to obtain sufficient appropriate audit evidence that unallocated deposits included in trade and other payables from exchange transactions had been properly accounted for, as the municipality did not allocate payments received from debtors. I was unable to confirm the unallocated deposits by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the payables from exchange transactions disclosed at R945,20 million in note 19 to the consolidated and separate financial statements. In addition, this could have an impact on consumer debtors, revenue and accumulated surplus.
8. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for payables and accruals included payables from exchange transactions. As described in note 65 to the consolidated and separate financial statements, the restatement was made to rectify a previous year misstatement. However, the restatement could not be substantiated by supporting evidence. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the payables from exchange transaction corresponding figure stated at R745,20 million in the consolidated and separate financial statements.

Related parties

9. The municipality did not correctly disclose related party transactions as required by SA Standard of GRAP 1, *Presentation of financial statements*. The municipality did not disclose comparative

information for related party transactions. Consequently, the comparative information relating to related party information disclosed in note 63 to the consolidated and separate financial statements was misstated. I was unable to determine the value of the misstatement as it was impractical to do so.

Statement of comparison of budget and actual amounts

10. The municipality did not correctly disclose budget and actual information as required by SA Standard of GRAP 24, *Presentation of budget information in financial statements*. The municipality did not disclose the final budget amounts for impairment of consumer and traffic fines. Consequently, the expenditure information disclosed in the statement of comparison of budget and actual amounts in note 28 to the consolidated and separate financial statements was misstated by an amount, which was impractical to determine.

Cash flow statement

11. The municipality did not prepare and disclose the cash flow statement on a cash basis as required by SA Standard of GRAP 2, *Cash flow statements*. Amounts included in the cash flow statement for the sale of goods and services, government grants and subsidies, interest revenue, employee costs, finance costs, payments to suppliers, purchase of property, plant and equipment, increase in capital work in progress as well as purchase of intangible assets, were disclosed on an accrual basis. Consequently, the cash flow statement presented in the consolidated and separate financial statements was misstated by an amount, which was impractical to determine.

Unauthorised expenditure

12. I was unable to obtain sufficient appropriate audit evidence as the amount disclosed for unauthorised expenditure differed from the underlying records. I was unable to confirm the balance of unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to unauthorised expenditure stated at R361,22 million (2017: R361,22 million) in note 70 to the consolidated and separate financial statements.

Additional disclosures in terms of MFMA

13. The municipality did not correctly disclose pension and medical aid deductions, as required by section 125(1)(c) of the MFMA due to the poor status of the accounting records. The amount relating to pension and medical aid deductions differed from the supporting documents by R50,12 million. Consequently, the amount relating to pension and medical aid deductions disclosed in note 59 to the consolidated and separate financial statements was understated by R50,12 million.

Aggregation of immaterial uncorrected misstatements

14. In addition to the individually material uncorrected misstatement in the disclosure notes, disclosure notes were materially misstated due to the cumulative effect of individually immaterial uncorrected misstatements in the following items.

Change in estimate – Property, plant and equipment

15. The municipality reviewed and changed the useful lives of property, plant and equipment in the current year, however; no disclosure of the impact of the change in estimate was made in the consolidated and separate financial statements as required by SA Standard of GRAP 3, *Accounting policies, changes in accounting estimates and errors*. It was impractical to determine the full extent of the misstatement for the change in estimate.

Commitments

16. The municipality did not properly account for commitments, as required by SA Standard of GRAP 17, *Property, plant and equipment* due to inadequate systems and processes to account for this disclosure. Resultantly, I was unable to determine the full extent of the misstatement.

Irregular expenditure

17. The municipality did not include irregular expenditure in the notes to the financial statements, as required by section 125(2)(d) of the MFMA. The municipality made payments in contravention of the supply chain management (SCM) regulations, resulting in irregular expenditure of R11,68 million. Consequently, irregular expenditure disclosed in note 67 to the consolidated and separate financial statements was understated by R11,68 million.

Operating leases

18. The municipality did not account for operating lease commitments, as required by SA Standard of GRAP 13 *Leases*. The municipality made payments relating to operating leases, however, no disclosure relating to future minimum lease payments, as required by SA Standard of GRAP 13, *Leases* was made in the consolidated and separate financial statements. I was unable to determine the full extent of the misstatement as it was impractical to do so.

Context for the opinion

19. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the consolidated and separate financial statements section of this auditor's report.
20. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
21. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse opinion.

Emphasis of matters

22. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

23. As disclosed in note 65 to the financial statements, the corresponding figures for 30 June 2017 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2018.

Material losses - electricity

24. As disclosed in note 71 to the financial statements, material electricity losses of R256,90 million (2016-2017: R279,12 million) were incurred, which represents 15% (2016-2017: 16%) of total electricity purchased. Losses were as a result of illegal connections, infrastructure vandalism and unmetered usage.

Material losses – water

25. As disclosed in note 71 to the financial statements, material water losses of R138,72 million (2016-2017: R109,21 million) were incurred, which represents 29% (2016-2017: 29%) of total water purchased. Losses were as a result of ageing water pipeline infrastructure.

Other matters

26. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

27. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and, accordingly, we do not express an opinion on it.

Unaudited supplementary schedules

28. The supplementary information set out on pages ... to ... does not form part of the consolidated and separate financial statements and is presented as additional information. We have not audited these schedules and, accordingly, we do not express an opinion on them.

Responsibilities of the accounting officer for the financial statements

29. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
30. In preparing the financial statements, the accounting officer is responsible for assessing the Msunduzi municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

31. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
32. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.
33. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit of the financial statements in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

Report on the audit of the annual performance report

Introduction and scope

34. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priority presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
35. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
36. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2018:

Development priority	Pages in the annual performance report
Development priority B – Basic service delivery	x – x

37. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

38. The material findings in respect of the usefulness and reliability of the selected development priority are as follows:

Development priority B – Basic service delivery

Various indicators

39. The reported achievements were inconsistent with the planned targets for the following indicators:

Indicator description	Planned target	Reported achievement
Kms of gravel roads to surfaced/concrete standard upgraded	0,4km of gravel roads to surfaced/concrete sidewalk at Siyahlomula Road upgraded by 30 June 2018	Completed sidewalks at Siyahlomula School and Ashdown Primary School by 30 June 2018
Date on which concrete bridge substructure, river embankment protection, and 0,26 km of gravel roadway completed	Concrete bridge substructure, river embankment protection, and 0,26 km of gravel roadway completed by 30 June 2018	Concrete substructure complete, reinforcement to deck partially complete, 0,26 subgrade of gravel roadway complete, embankment protection partially complete
Metres of berm constructed and metre height	250 x metres of berm constructed to 2,5m height by 31 May 2018	246,5 x metres of berm constructed by 31 May 2018

Various indicators

40. The reported measures taken to improve performance against the planned target did not agree to the supporting evidence provided for the indicators listed below. Based on the supporting evidence provided, the measures taken to improve performance could not be verified as the evidence submitted for audit did not show any evidence of the corrective measure.

Indicator description	Planned target	Reported achievement
Kilometres of water pipe replaced	2 km of water pipe replaced by 30 June 2018	1,7 km of water piped replaced by the 30th of June 2018

Kilometres of water pipe replaced	Four stream crossings completed by 30 June 2018	50% of Three stream crossings completed by 30 June 2018.
Date Phase 2 of Draft Sanitation Master Plan and Draft WSDP submitted to SMC for consideration	Phase 2 of Draft Sanitation Master Plan and Draft WSDP submitted to SMC for consideration by 30 June 2018	72% of review of the Draft Water Master Plan and WSDP was completed by 30 June 2018.

Various indicators

41. The reported achievement in the annual performance report did not agree to the supporting evidence provided for the indicators listed below. The supporting evidence provided indicated that the achievements of these indicators was as follows:

Indicator description	Reported achievement	Audited value
Km of gravel roads to surfaced/concrete standard upgraded	Completed sidewalks at Siyahlomula School and Ashdown Primary School by 30 June 2018	2 meters of concrete road completed
Km of gravel roads upgraded to black top surface in Harewood Ward 20	Currently busy with provision of drainage of 0,7km (4200m sqm) of gravel roads upgraded to asphalt surface standard by 30 March 2018	The overall achievement on the project was 46%
Sqm of landfill site reshaped	0 sqm of landfill site reshaped by 30 June 2018	An area of 88 224 square metres was levelled
% completion of base course	0 % completion of base course by 31 December 2017	100% completion of base course

Number of households with access to refuse removal at least once per week (wards 10 - 37)

42. The reported achievement of "64 813 with access to refuse removal at least once per week by 30 June 2018 (wards 10 -37)" for the target "Approximately 120 000 households with access to refuse removal at least once per week by 30 June 2018 (wards 10 - 37)" is not reliable as the municipality did not have an adequate performance management system to maintain records to enable reliable reporting on the achievement of the target. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any further adjustment was required to the reported achievement.

Other matters

43. I draw attention to the matters below.

Achievement of planned targets

44. The annual performance report on pages ... to ... includes information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 39 to 42 of this report.

Adjustment of material misstatements

45. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information on the basic service delivery development priority. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

46. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
47. The material findings on compliance with specific matters in key legislation are as follows:

Financial statements

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving an adverse audit opinion.

Procurement and contract management

49. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by Municipal Supply Chain Management Regulations GNR 868 OF 30 May 2005 (MSCMR) 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of MSCMR 36(1).

Expenditure management

50. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for adverse paragraph. The majority of the disclosed irregular expenditure was caused by non-compliance with MSCMR.
51. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R10,97 million, as disclosed in note 69 to the annual financial statements, in contravention of section 62(1)(d) of

the MFMA. Most of the disclosed fruitless and wasteful expenditure was caused by investigations into employees on suspension that were not finalised on time.

52. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(c) of the MFMA.

Revenue management

53. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.

54. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

55. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

56. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

57. Unauthorised expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.

58. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Strategic planning and performance management

59. Annual performance objectives and indicators were not included in the municipal entity's multi-year business plan, as required by section 93B(a) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).

60. The performance of the municipal entity was not monitored and reviewed as part of the annual budget process, as required by section 93B(b) of the MSA.

Human resource management

61. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted, as required by section 67(1)(d) of the MSA.

Other information

62. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the consolidated and separate financial statements, the auditor's report and that selected development priority presented in the annual performance report that have been specifically reported in this auditor's report.

63. My opinion on the consolidated and separate financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
64. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected development priority presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
65. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information and, I conclude that it contains a material misstatement, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to withdraw this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

66. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it.
67. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for adverse opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
68. Leadership did not ensure that effective measures were taken to address previous findings to support the achievement of credible reporting and compliance with legislative requirements.
69. Management did not implement a proper records management system to maintain documents supporting reported performance information, assets, revenue and expenditure.
70. Systems and controls were not designed in a manner that would prevent, detect and address risks that had an impact on financial, performance and compliance reporting. In this regard, management did not ensure that regular, accurate and complete financial and performance reports that were supported and evidenced by credible information were prepared.
71. Management did not conduct appropriate risk management activities to ensure that regular risk assessments, including the consideration of information technology risks, are performed adequately and that a risk strategy is sufficiently monitored to address the risks.

Other reports

72. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
73. The internal audit unit performed numerous investigations at the request of the accounting officer and senior management, regarding allegations received from the whistle-blower hotline. These investigations related to allegations of fraud, corruption, theft, recruitment, mismanagement and supply chain management irregularities. During the 2017-18 financial year, thirty-six investigations were conducted. Of the thirty-six investigations conducted, twenty-nine were concluded and reported to council. Seven cases relating to recruitment, corruption, misconduct and theft were still in progress at the date of this report.

Auditor-General

Pietermaritzburg

07 February 2019



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Msunduzi Municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.